

PREFACE/CLASS OUTLINE
ACQUISITION AND LOGISTICS EXCELLENCE WEEK 2001

TOPIC: Price-Based Acquisition

LENGTH/TYPE: 1 hour – Lecture/Discussion

SCOPE: This presentation outlines the basic concepts of the price base acquisition initiative. The module discusses the transition from Cost-Based to Price Based Acquisition. The transition toward Price Based Acquisition (PBA) is integrated with the requirement for Price Reasonableness and the determination of whether Cost or Pricing data are required per the Truth in Negotiations Act. A timely report from the DoDIG sheds light on the challenges DoD faces in this effort. PBA addresses new skills required of all acquisition professionals to determine the value of goods and services over their useful life without depending on DoD accounting standards or supplier provided cost data. All acquisition professionals will benefit from this workshop.

LEARNING OBJECTIVES: Given information provided in the workshop,

1. Students will be familiar with the benefits of using Price-Based Acquisition.
2. Students will be able to recognize PBA key concepts so that future acquisition decisions can more effectively o implement Price-Based Acquisition techniques.
3. Students will recognize potential settings that favor use of Price-Based Acquisition.

MATERIALS:

Briefing Charts

Implementing Price-Based Acquisition



Welcome to Price-Based Acquisition, or PBA. PBA is how business does business. PBA is a broad approach which can have many facets and enhance our Government acquisition endeavors.


This block, provides some background on PBA, what it is designed to accomplish, and some of its benefits. To accomplish this, we first need to talk about PBA in the context of other acquisition approaches. PBA, as an alternative to “business as usual” in the Government, is where its greatest value lies.

In the next hour, we’ll mostly concentrate on the price related initiatives. But as we go through this material, please remember that PBA is much more than just a pricing focus. It is being used to spearhead multiple initiatives to transform the way DoD is buying its products and services. The ultimate goal of PBA is to transform DoD buys practices to be more commercial-like. This overarching PBA thrust will affect not only what we buy, but, how we will buy it. And why would we want to change the way we buy? To get better products and services at better terms and prices, from better vendors under better conditions!

A&L WEEK

DoD Guidance for Price-Based Acquisition


“...we must change over to price-based acquisition practices--to establish contractual relationships that use price analysis as compared to cost analysis (either incurred or anticipated). This is the primary way the commercial world functions. This will be the primary way we must function too. Priced-based acquisition must become the norm--with cost-based the rare exception...”



USD (AT&L), December 2, 1998

A&L WEEK

Acquisition
&
Logistics
Excellence



08/09/01

Implementing Price-Based Acquisition

2

This slide contains an excerpt from a speech that the former Under Secretary of Defense for Acquisition, Technology and Logistics, Dr Gansler, a leading proponent of PBA, provided. Priced-Based Acquisition is the establishment of a contractual relationship based on price instead of cost.


This excerpt highlights that Price-Based Acquisition has the attention of the very senior-most officials in DoD procurement. That senior level is serious about implementing PBA.

Note to Instructor: Read through the entire excerpt and emphasize the tenor of the quote. DoD acquisition will use Price-Based Acquisition as its normal operating process. It is not saying that DoD is considering using Price-Based Acquisition as an approach, he is saying that DoD must change over to PBA practices. “Cost-based” will become not only the exception, the “rare exception”.


A&L WEEK

PBA - “Government” History

- FY98 Nat’l Def Auth Act directed SECDEF review organizations and functions of DoD acquisition
- PBA Study Group established by USD(AT&L) 10/98 - analyze implementation of PBA in DoD
- Study Group - not whether DoD should do PBA, but “how to make it happen”
- 12/98 Government/Industry Roundtable explored industry’s use of PBA best practices. (Office of SECDEF Def/Ind PBA Roundtable)
- Study Group initial report 4/99
- 11/15/99 PBA Report released
- 11/29/00 USD (AT&L) publishes study group findings (with cover-sheet caveat) and urges further implementation of PBA DoD-wide.

Acquisition & Logistics Excellence


08/09/01
 Implementing Price-Based Acquisition


 3

First, some background and history of PBA to:

Gain proper perspective and positioning of PBA in Government acquisition, and Appreciate the context from which PBA arose.

Momentum for PBA has been building in the Government in recent years. We (meaning DoD) are where we are now with respect to PBA because of the steps and initiatives shown on this and the next two slides.

Briefly reviewing these slides gives us a greater appreciation of the amount of thought that has gone into this Acquisition Initiative and to demonstrate the depth of commitment at senior levels.

Another item that bears noting. Look at the third bullet on this slide. Note that the study group that was established to analyze implementation of PBA. Its purpose was not to study whether PBA should be used - but, rather, to figure HOW TO MAKE IT HAPPEN. Its charter actually states they were to:

Analyze the implementation of price-based acquisition in the Department of Defense (DoD),

Identify specific tools and techniques to facilitate greater use of price-based acquisition within the Department, and

Identify what actions (statutory, regulatory, and policy) will be required to transform the Department's buying practices into ones that are more commercial-like.

The final bullet says there wasn't a consensus on the findings – more work needs to be done.

Paints a pretty clear picture, doesn't it? Expect Price-Based Acquisition to take a central role in Acquisition Initiatives in the future.

A&L WEEK

Acquisition
&
Logistics
Excellence

Study Group Outcomes: PBA Report

- “Increase access to leading edge technology in the commercial sector,
- Reduce Government infrastructure
- Get better prices for what we buy.”

08/09/01

Implementing Price-Based Acquisition

4

Here is the major thrust of the report. The PBA group, and by expansion all DoD, desires to accomplish:

- (1) Increasing DoD's access to leading edge technology available only in the commercial sector,
- (2) Reducing Government infrastructure, and
- (3) Getting better prices for what we buy.”

These outcomes are also part of the objectives that PBA, as an approach, seeks to accomplish. We'll talk about these outcomes later.

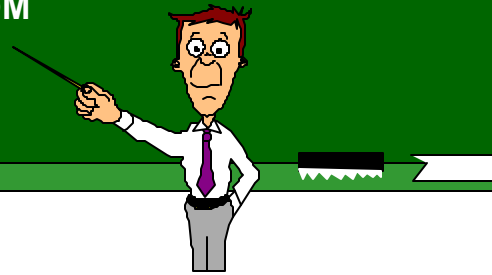
A Draft of the report is available on this website:
<http://www.acq.osd.mil/ar/doc/pbarpt.pdf>

A&L WEEK

Acquisition & Logistics Excellence

Where We're Headed... .

- Where have we been?
- Before we can fully understand Price Based Acquisition as a fundamental shift in acquisition, we need to understand what it is a **SHIFT FROM**



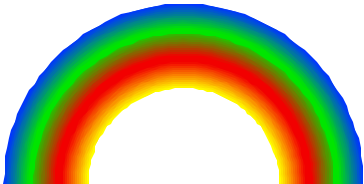
08/09/01 Implementing Price-Based Acquisition 5

Since we are headed to Price-Based Acquisition and this move is, indeed, a fundamental shift, we need to understand where we are moving from and why. Before we change- and PBA is, indeed a change- we need to understand why we are changing and from what.

So, where have we been; or at least where have we spent considerable time and resources?

A&L WEEK
 Acquisition
&
Logistics
Excellence

The Cost/Price Continuum



Cost-Based
Price-Based

- **We've all heard of the Best Value Continuum**
- **But there's another continuum: THE COST/PRICE CONTINUUM**
- **Shift from CBA to PBA along this continuum**
- **Cost analysis vs price analysis**

08/09/01
Implementing Price-Based Acquisition
6

How many have heard of the Best Value Continuum? This is a concept set forth in Part 15 of the FAR and was part of its fairly recent re-write. This continuum articulates the variety of methods we have for achieving best value as a result of an acquisition process.

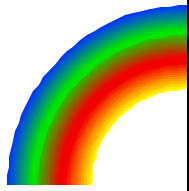
Another major continuum in acquisition is the Cost/Price Continuum, although it's not often expressed in that way. This Cost/Price Continuum has Cost-Based Acquisition (CBA) at one end and Price-Based Acquisition (PBA) at the other. On this continuum, we may have a mixture of these two approaches; we need to plan and prepare for the approach we take because of the dramatic effect it will have over a given acquisition.

Along with this Cost/Price Continuum, we could say that we have another parallel continuum, called the Cost Analysis/Price Analysis continuum. These are parallel because the approach we employ in the analysis of offers will coincide with and support the acquisition decision of whether we use PBA concepts and techniques or CBA concepts and techniques.

Today, we are being pulled (or pushed depending on our perspective) along this continuum toward the PBA end.

A&L WEEK

CBA: One End of the Continuum



CBA

What is Cost-Based Analysis??

- Acquisition approach that relies heavily upon “cost or pricing” data
- Serves as foundation for contract amount
- Contract Administration focus on cost incurred or expended
- NOT results oriented**

08/09/01

Implementing Price-Based Acquisition

7

Let us step back a moment and consider the concept of Cost-Based Acquisition (relying heavily on contractor supplied and certified Cost or Pricing Data) and its impact on Government acquisition practices and the marketplace. Cost-Based Acquisition has been used a great deal by both DoD and the rest of the federal Government.

This is where we’ve been and where we have spent - not always wisely - considerable resources: ours and our suppliers’ over the years.

This is the end of the rainbow from which we are attempting to move.

CBA, mainly relies on contractor provided (certified) cost or pricing data and the analysis of that data, which usually involves cost analysis as the technique for evaluating the proposed costs. QUESTION: Can anyone explain the basic difference between cost analysis and price analysis, or provide a working definition of cost analysis? QUESTION: When we perform cost analyses, what process do we employ?


Cost-Based Acquisition not only focuses on cost or pricing data and a detailed analysis of that data prior to award, but after award - for cost-type contracts - much of the Government’s efforts are directed at managing cost. The Government becomes much more concerned with cost data, cost reporting, invoice substantiation, etc, than it does when using a Price-based Acquisition approach. Often the time and attention paid to costs under CBA - the structure of the costs, the categorizations of the costs and the substantiation of the costs - cause us to lose sight of the contract performance, i.e., the reason for the contract in the first place.

A&L WEEK

Cost or Pricing Data, What Is It?

All facts that, ... buyers and sellers would reasonably expect to affect price negotiations significantly. Cost or pricing data are data requiring certification. Cost or pricing data are factual, not judgmental; and are verifiable. While they do not indicate accuracy of contractor's judgment about estimated future costs or projections, they do include data forming basis for judgment. Cost or pricing data are more than historical accounting data; they are all facts that can be reasonably expected to contribute to soundness of estimates of future costs and validity of determinations of costs already incurred. They also include such factors as: vendor quotations; nonrecurring costs; information on changes in production methods and in production or purchasing volume; data supporting projections of business prospects and objectives and related operations costs; unit-cost trends such as those associated with labor efficiency; make-or-buy decisions; estimated resources to attain business goals; and information on management decisions that could have a significant bearing on costs.

FAR 15.401

Acquisition & Logistics Excellence

 08/09/01

Implementing Price-Based Acquisition

8

Cost-Based Acquisition brings into play a term known to make grown men and women who work for industry weep aloud. The term is Cost or Pricing Data. Cost or Pricing Data and the baggage - legal, financial and contractual - that it carries can be the bane of a commercial entity's efficient existence.

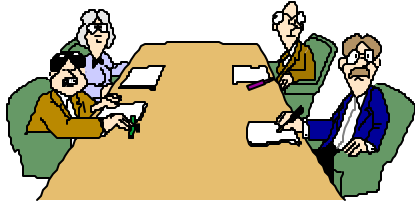
Notice that the word "or" in the title Cost or Pricing Data is underlined. This is for a distinct purpose. The name of this term is not Cost and Pricing Data, which is what many people call it. While it may seem like a subtle distinction, there is an enormous difference between the two terms. The term "Cost or Pricing Data" is defined by FAR, and is the basis for the expenditure of many millions of dollars for compliance and the focus of thousands of jobs.

Notice, also, that in the definition, the words "all facts" are underlined. This is to highlight the enormous pervasiveness and all-inclusivity of the definition. This definition both spins a web that snares businesses - sometimes to their serious detriment, and builds a serious barrier preventing good firms from entering into the Government marketplace.

A&LE WEEK


Cost or Pricing Data and Its Certification

“When cost or pricing data are required, Contracting Officer shall require submission of (1) cost or pricing data, and (2) CERTIFICATE that “to the best of its knowledge and belief, the cost or pricing data were accurate, complete and current...”



Part 15.403-4

Acquisition
&
Logistics
Excellence



08/09/01

Implementing Price-Based Acquisition

9

Think about the definition on the previous slide, especially of the term “all facts”. Now take a look at this excerpt from the FAR. Generating and submitting the data is burden enough, but that’s the easy part of the transaction. Once submitted, it must be certified.


Look at the standards in this certification: “best of its knowledge and belief” “accurate, current and complete”. Consider the obligations and the risks imparted by the certification. On the other hand, consider the risks to the Government that motivate such action.

The contractor also is signing up to a complete examination “at any time before award, those records, which include books, documents, accounting procedures and practices, and other data, regardless of type and form or whether such supporting information is specifically referenced or included in the proposal as the basis for pricing, that will permit an adequate evaluation of the proposed price.” (FAR 15.408 Table 15-2)

Very onerous requirements.

ALE WEEK

Acquisition
&
Logistics
Excellence



DoDIG Report: Determinations of Prices Reasonableness where Cost or Pricing Data were not Obtained

Results:

- ✎ Lack of valid exceptions from cost or pricing data
- ✎ Failure to obtain required data
- ✎ Price analysis did not adequately support price reasonableness
- ✎ Items categorized as commercial were not challenged
- ✎ Prices accepted based on contractor catalogs without analysis
- ✎ Questionable competition as a basis for accepting price
- ✎ Reliance on unverified prices from prior contracts as a basis for determining that current prices were reasonable

www.dodig.osd.mil. Report D-2001-129, May '01

08/09/01
Implementing Price-Based Acquisition
10

Many benefits may accrue to the Government when cost or pricing data are not required. However, as the following charts demonstrate, when exceptions to cost or pricing data are improperly applied, our customers are not well-served nor can we be certain that prices paid are fair and reasonable. If the exceptions do not apply, then cost or pricing data is required.

At the end of May 2001, the DoDIG published an audit concerning ***Contracting Officer Determinations of Price Reasonableness When Cost or Pricing Data Were Not Obtained*** (D-2001-129, May 2001). The report is relevant to our subject today because both *price reasonableness* and *cost or pricing data* are key elements of Price-Based Analysis. The objective of the report was to determine whether contracting officials obtained information, in accordance with the Federal Acquisition Regulation, to determine price reasonableness when [certified] cost or pricing data were not required, and whether these reasonableness determinations were adequate.

The report found that contracting officials lacked valid exceptions from obtaining [] cost or pricing data and failed to obtain required data in 32% of the contracting actions examined. In addition, price analysis documentation did not adequately support price reasonableness in 86% of those actions. Also, contracting officials did not challenge items categorized as commercial, and they accepted prices based on contractor catalogs and price lists without analyses. Contracting officials used questionable competition as a basis for accepting contractor prices and relied upon unverified prices from prior contracts as a basis for determining that current prices were reasonable. Problems contributing to poor price analysis included an atmosphere of urgency caused

by a lack of planning, staffing shortages, the need for additional senior leadership oversight, and a generally perceived lack of emphasis on obtaining cost or pricing data.

| Invalid Exceptions, Inadequate Price Justifications, Overpriced Actions | | | | |
|---|------------------|-------------------|--------------------------------|--|
| Exception Used | Contract Actions | Invalid Exception | Inadequate Price Justification | Data Sufficient To Compute Overpricing |
| Commercial | 46 | 11 | 42 | 12 |
| Competition | 16 | 9 | 9 | 9 |
| Waiver | 8 | 4 | 4 | 1 |
| No Exception | 16 | 16 | 16 | 5 |
| Threshold | 59 | 6 | 53 | 25 |
| Total | 145 | 46 | 124 | 52 |

The DODIG report found that contracting officials used invalid exceptions as a basis for not obtaining cost or pricing data. Further, they inappropriately used exceptions to enable them to award contracts more quickly and avoid delays caused by contractor unwillingness to provide such data.

Contracting officials on their own or at the request of contractors classified items as commercial, improperly determined that adequate price competition existed, and improperly used waivers, all to avoid having to obtain [certified] cost or pricing data.. Contracting officials also awarded actions valued at more than \$500,000 without obtaining cost or pricing data or without using any of the exceptions. Contracting officials also lost the opportunity to obtain cost or pricing data by not combining actions and awarding actions slightly below the \$500,000 threshold.

This chart provides a breakdown of invalid exceptions along with all of the inadequate documentation supporting price justification and overpriced actions.


Of the 145 contract actions, 62 were below the \$500,000 threshold [Instructor: These actions were date prior to the change in the dollar threshold from \$500,000 to \$550,000.] Fifty-nine of these actions used the threshold as the exception from obtaining cost or pricing data including 6 that circumvented the threshold and were classified by the Inspector General as invalid exceptions. Three of the 62 actions used the commercial item status as the exception.

A&L WEEK


So How Does Industry Do It?

Vast majority of commercial business

- **Not based on cost or pricing data**
- **Not certified**
- **Invoice based on performance**



Acquisition
&
Logistics
Excellence



08/09/01
 Implementing Price-Based Acquisition
12

The big deal with Cost-Based Acquisition and requiring Cost or Pricing Data is that both concepts only not well known or understood by the commercial marketplace. They are also avoided as much as possible. The vast majority of business deals in the commercial marketplace, aside from those flow-down Government subcontract deals, do not have the supplier providing detailed cost data on what it expects to incur. Commercial deals do not envision providing this data or opening the corporate books of the supplier to the potential buyer. Furthermore, these deals do not contemplate the supplier then swearing, on an oath, as to the accuracy of the data - the accuracy being based upon an accounting system used by probably far less than 1% of all the businesses operating in America today.


After a commercial award, the party performing provides the services and/or goods. Concurrent with the work, the provider submits an invoice based, on performance during the billing period. The buyer, after satisfying itself of the adequacy of the performance, pays the invoice. The performing party does not submit detailed, certified data covering such items as actual labor rates, actual labor overhead, G&A, profit margins, etc., nor does the buyer want to deal with that avalanche of data.

A&L WEEK


Does CBA & C/P Data Come with a Price???

Yes, Yes and Yes

- Cost to prepare/provide data (systems, sweeps and maintenance) if business is CAS compliant
- The “hidden cost” of requiring CBA & C/P data
 - The “no bid” decision. Results in:
 - Reduced competition (ultimately higher prices)
 - Reduced access to good technology/solutions
 - Reduced access to great business ideas/practices



Acquisition & Logistics Excellence



08/09/01

Implementing Price-Based Acquisition

13

CBA and the requirement to submit Cost or Pricing Data does, come with a cost. If businesses want to become CAS compliant, there is a definite cost to an organization required to submit Cost or Pricing Data. Special accounting systems and procedures are required. Specialized accounting expertise is needed to install and operate these systems. In one example, a division of a large company, with the division employing 3,000 people with only a small portion to be engaged in the Government marketplace, explored the cost of instituting an accounting system that would be Government Cost Accounting Standards compliant. The initial cost was estimated to be \$500,000, not to mention permanent on-going costs. What this meant to the decision-makers was that the profit from at least \$5,000,000 of business revenue would be cancelled out in the first year, just to have the specialized accounting system installed. The decision was that it would be a poor return on investment given what the \$5,000,000 could earn in the commercial marketplace.

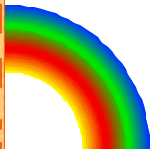
There is another hidden cost to Cost or Pricing Data procurements - hidden to the Government, well known to industry. Accounting rules make certain expenses unallowable, meaning they cannot be billed to Government contracts. What this means is that the commercial sector of that business may be called upon to absorb those expenses. The result is that it may make the commercial business less profitable. Consider the commercial division with its senior management who may be compensated based upon their profitability. Do you think they're happy their company wants to do Government business?

The cost to implement and operate a specialized accounting system is just one cost. There are others when a procurement requires Cost or Pricing Data. Many good

businesses decline to participate solely because of the cost or pricing data requirement, period. Less competition means higher prices. Cost or pricing data requirements serve as a barrier and reduce Government access to the solutions and technology that could otherwise be offered by those firms declining to bid. Finally, the Government loses the chance to do business with those firms with good ideas, practices and techniques, and who are willing to share them.

A&L WEEK

Defining PBA



- **Streamlined Definition -**
Price-based acquisition is a way for DoD to buy goods and services that does not rely primarily on a supplier providing cost data
- **Detailed Definition -**
PBA - way of doing business that begins with identification of need and flows through post-award activities. Decision to use price-based approach is driven by choices made during Requirements Definition process, is heavily dependent on risk mitigation and the chosen acquisition strategy, and is aided by competition or alternatives. In its purest form, PBA results in a firm-fixed-price (or fixed-price with performance incentives) contract and a fair and reasonable price is established without obtaining supplier cost data.

08/09/01

Implementing Price-Based Acquisition

14

This simple definition says a lot and cuts to the heart of one of the key concepts of Price-Based Acquisition. This says that the Government, when using PBA techniques buys supplies and services without relying - which also means not requiring - on supplier providing cost data, which means Cost or Pricing Data.

When engaging in Price-Based Acquisitions which, as we mentioned are at the opposite end of the Cost/Price Continuum from Cost, the buyer should utilize Price Analysis techniques. We'll talk more about Price Analysis techniques in a few moments.

While I read this definition out loud think hard about what it is saying to us. (Then read definition.)

This says PBA is more than a point on the Cost/Price Continuum; it is a way of doing business.

This definition also takes us into the decision-making process. When do we decide to use Price-Based Acquisition? The answer is based upon a combination of factors such as risk, acquisition strategy and competition. It is also affected by the supplies or services that we buy and the amount of information - regarding both prices and performance - available to us. Later, we'll touch again on the question of when we might want to use PBA.

These definitions were used by the DoD PBA Study Group report.

A&L WEEK

Price Analysis & Techniques

- **Price Analysis:** Process of examining and evaluating proposed price without evaluating separate cost elements and proposed profit (FAR 15.404-1(b))
- **Price Analysis strongly supports PBA**
- **Price analysis techniques include**
 - price comparisons- proposed and/or previous prices
 - parametric estimating methods
 - competitive price lists and market prices
 - comparison with IGE
 - comparison of proposed price to prices obtained through market research *for the same or similar items
 - analysis of pricing info provided by offeror

08/09/01

Implementing Price-Based Acquisition

15

We mentioned earlier that Cost Analysis means, looking at and examining the various specific, discrete elements that comprise the cost proposal. Well, to no one's surprise, Price Analysis, therefore, means not delving into that detail. Price Analysis has a specific definition in the FAR which is provided on this slide.

The FAR says we can use various price analysis techniques and procedures. It goes on to provide some examples [CHART].


One of the great virtues is the flexibility of Price Analysis. The more studied and conscientious the buyer is, the more effective can be the balance in the age old scale between burdening the supplier with data requirements and having enough- and the right kind- of information to make effective buying decisions. Too often the Government has overloaded the scale in favor of data requirements. Also, too often we tend to be more interested with "how much" data can be extracted from the supplier than with "how effective" the data available really is.

This slide presents a list of various techniques. Most are flexible for the innovative acquisition professional. For example, look at the one with the asterisk "Comparison of proposed prices with prices obtained through market research for the same or similar items." Prices used in the comparison can be from Government deals or they can be from commercial deals. The information may be gleaned from buyers or from sellers.

The type of data needed is up to the Contracting Officer - and exemplifies the opportunity for exercise of discretion and judgment emphasized in the FAR today. It is just this sort of flexibility, discretion and judgment that is at the very heart of PRICE-BASED ACQUISITION.

A&L WEEK

Acquisition
&
Logistics
Excellence



Commercial Items: Price Analysis Techniques

Commercial items are excepted from requirement to obtain cost or pricing data and from FAR Cost Accounting Standards applicability. Includes awards and mods

- Price Analysis Techniques described earlier, plus more Part 15 input**
- Information other than Cost or Pricing Data**
 - Contractor format
 - Sales data for similar items
 - Limit scope of information request to that regularly maintained by offerors
 - Information exempt from disclosure shall not be disclosed outside government
 - Information shall contain pricing data adequate for determining reasonableness

08/09/01
Implementing Price-Based Acquisition
16

In addition to the Price Analysis techniques on the previous slide, the FAR provides additional guidance that helps our proposal analysis, especially when buying commercial items. However, these ideas are not solely limited to commercial item buys.

When buying a commercial item, the FAR, Part 15, says cost or pricing data shall not be required. Same for post award commercial item mods. This means that items meeting definition of commercial item in Part 2 will not require submission of Cost or Pricing Data.

If there is a need for additional information, we call that “information other than cost or pricing data” and there are some constraints & guidelines in Part 15 such as:

- (1) Contractor's format for submitting such information should be used;
- (2) Requests for sales data relating to commercial items shall be limited to data for same or similar items during relevant time period;
- (3) Contracting Officer shall limit scope of request for information relating to commercial items to include only information that is in a form regularly maintained by offeror as part of its commercial operations;
- (4) Information obtained relating to commercial items that is exempt from disclosure under 24.202(a) or the Freedom of Information Act (5 U.S.C. 552(b)) shall not be disclosed outside Government;
- (5) Information submitted by offeror shall include, at a minimum, appropriate information on prices at which same item or similar items have previously been sold, adequate for determining reasonableness.


A&LE WEEK

Non-Commercial Items Price Analysis Techniques

[But, why are you buying non-commercial in the first place?] Review FAR Part 2 definition of Commercial Item

[But if it really is non-commercial, what should you use?]

Everything we've covered so far plus what ever else makes sense to demonstrate or document a fair result.



Acquisition & Logistics Excellence

08/09/01

Implementing Price-Based Acquisition

17

Before a decision is made to go non-commercial, the first thing that the Acquisition Team should answer is the question: "Why is this not a commercial item acquisition?" Remember, regulations establish a clear preference for buying commercial items. They even go so far as to state that we should go back and re-visit the Government's need and see if we can perhaps change or modify the need so that we are able to buy a commercial item.

Of course, we can't make a determination whether to go commercial or not until we decide whether the item is or is not a commercial item. How do we make this determination? The Acquisition Team should turn to Part 2 of the FAR and carefully read the definition. The definition is and was meant to be broad and expansive. This course was not designed to go into the specific components of this definition, but it is important to recognize that the definition does possess significant breadth.

OK, but what if what we're buying really is non-commercial? What Price Analysis techniques may we use? The short answer is anything we've listed or described so far as well as any other methods that make good sense and lead to a fair result - one that we can demonstrate or document!

Finally, even if the overall item we're buying is not commercial, parts or components of it may be and thus appropriate for some degree of PBA techniques.

A&L WEEK

5 “K’s” To A Fair & Reasonable Price

- Use these 5 “K’s” to help: (a) obtain a fair and reasonable price, and (b) make your acquisitions Price-Based:


Know what you buy - products, services


Know where you buy - the marketplace

Know how you will buy - approach, criteria, etc

Know how to use competition - actual or perceived

Know how to negotiate - look out for yourself & build effective relationships



Acquisition & Logistics Excellence

 08/09/01

Implementing Price-Based Acquisition

18

Here is a formula that should almost always work. This formula should result in fair and reasonable prices, fair and reasonable business relationships and solid performance. Price-Based Acquisition concepts are implicit in these 5 K’s. These 5 K’s are also implicit in Price-Based Acquisition. If you study the most effective and successful acquisition professionals, you’ll find that they use these 5 “K’s”, even if they do not expressly think that they are following a formula.

Making a thorough study of these is a major course of study in itself, so we’ll just briefly go over them.

1. Know what you’ll buy. While contracts people don’t need to know how to build what they’re buying, they do need to know its purpose. Too often, contracts people are reluctant to increase their product and service knowledge and, instead, rely on their customer. More effort needs to be made to understand what they’re buying. The effort will pay off.
2. Know where you’ll buy. This means market research and understanding the marketplace. Know the business practices and customs in that industry. Know who the players are and what they produce, how good it is and the price, quality and technology trends. Know how business operate both when they act as buyers and when they act as sellers. There is a huge difference between these two.
3. Know how you’ll buy. What kind of acquisition is contemplated: Part 12, 13, 14, or 15? Low Price Technically Acceptable or Tradeoff? What are your evaluation factors; which are most and least important? How will you gather the data?


What type of contract will you use? What terms and conditions will you employ?
Who will assist in the evaluation?

4. Know how to use competition. How do you stimulate it? How do you use competition for effective results, which is more than just low price, but great performance and solid past performance?
5. Know how to negotiate. Negotiation skills are the single most important skillset any contracts person can develop; one, to make sure you get the best deal you can, and two, to structure a relationship to which both parties are committed.


A&L WEEK

Value-Based/Worth-Based

- Inherent and operative in most all commercial marketplace buy/sell and sell/buy transactions. Opportunity to use in Government procurements as well
- What sets the final price? Value/worth to customer plus vigorous negotiations
- Determining worth/value to Government: homework, market research, team effort



Acquisition & Logistics Excellence



08/09/01

Implementing Price-Based Acquisition

19

How many have heard of the terms Value-Based or Worth-Based? These are terms that some may not have heard before. These terms and their approach are somewhat implicit in Part 15, in 15.404-1(b)(4), where it all too briefly mentions that: “Value analysis can give insight into the relative worth of a product and the Government may use it in conjunction with price analysis techniques.”


The 5 K's from the prior slide - concentrating knowledge and the application of knowledge - underlie and support Value and Worth-Based Acquisition.

In many, if not most commercial acquisitions, the price that the buyer is willing to pay is first based upon the worth or the value of the product or service being proposed. In other words, commercial buyers assess or assign a value to what they want to buy. They ask themselves, either formally through a mathematical or business process (answering the question “What is this worth to us?”). At the same time, the effective selling business is hard at work selling value and worth to the customer. The seller is attempting to build up the value in the customer's eyes. It is up to the smart buyer to recognize and determine real value and negotiate a price based on that real value. Of course, environmental issues such as competition- supply and demand - timing, and others may affect the price or the value. And, where does the smart buyer get the information to help establish the worth to it of the item? There are no automatic or easy ways. Frankly, the buyer works hard and works smart within the construct of the Acquisition Team. The smart buyer is one who leans heavily on the customer to come up with information to support the value determination. This should be the case whether the buyer is a commercial or Government buyer.

Here's an incentive where the commercial buyer may have to work hard and smart. Imagine explaining to the boss why you paid \$100,000 for an item actually only worth \$25,000 to your business. This same incentive should also work in the Government. But remember, if you demand Cost or Pricing Data, you may actually drive up the price. So, Cost or Pricing Data may increase cost or price, but it won't increase worth or value.

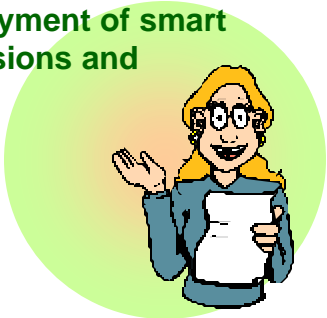
A&L WEEK

Acquisition
&
Logistics
Excellence



PBA - A Change in Focus

- From cost to price
- From cost capture, tracking and containment to performance
- BUT there's more to it. PBA EQUALS change in focus, PLUS performance outcome perspective, PLUS employment of smart business initiatives, decisions and approaches**




08/09/01
Implementing Price-Based Acquisition
20

PBA is a change in approach, mindset and focus. It takes our focus away from costs, estimated costs, incurred costs, etc., and places it on non-cost data. Another focus for PBA is that of performance and performance outcomes. But, PBA is not something that you wind up and let it run by itself. The best results from PBA occur when PBA is combined with a solid focus on the outcomes the Government desires through the performance under the contract. Smart business techniques, initiatives and decisions employed by the acquisition team will support the PBA thrust and multiply its positive effects.


A&L WEEK

Some Initiatives & Approaches

- PBA is more than just price analysis!!! It's a way of doing business in more "commercial-like" fashion.
- Some ideas/recommendations from the PBA study group:
 - > Don't automatically use cost plus for high risk efforts - manage risk, use incremental, evolutionary approaches
 - > Create market research organizations: DoD & service-wide; make buyers smarter
 - > ORDs should include the value to the user- should discourage unaffordable approaches
 - > Past performance eval factor at least equal to highest factor over 1MM
 - > In settling claims, large programs have ADR to avoid cost data issues
 - > New termination clause for non-commercial contracts



Acquisition
&
Logistics
Excellence



08/09/01

Implementing Price-Based Acquisition

21

As we mentioned earlier, PBA is more than just a shift from CBP to PBA. It actually embraces a variety of prudent business techniques and practices. Remember, also, a permanent goal to get better products and services, at better terms and prices, from better vendors under better conditions.

The PBA Study Group made several recommendations to improve buying practices. Some of these they developed and some they adopted or adapted from other acquisition groups.

This slide contains just a few ideas that have been raised.

First one, eliminating an automatic use of cost plus for high risk efforts. Before we latch onto cost plus as the only approach when facing high risk, first look for alternatives. Maybe an incremental approach - where the work is broken down into smaller pieces will allow us to use a series of fixed priced contracts. We'll talk more about this later.

There is huge emphasis on market research. One area where commercial buyers have an advantage over Government buyers - and which supports their being able to use Price-Based techniques - is their knowledge of what they buy and the marketplace in which it is produced, bought and sold. We need to establish the mechanism for Government buyers to obtain and use this same information. However, no systems or centers can substitute for the plain old-fashioned hard work of learning on your own.

ORD's (Operational Requirements Documents). Find out up front just what value the user places on what he or she needs. This can also help avoid wasting resources chasing unaffordable solutions.


Make much more use of past performance. To reach the great businesses and get the great performance, make past performance even more important than it is today. One idea would have it equal to the most important factor on procurements over \$1 million.

Much effort is wasted in settling claims and this scares good businesses. Use ADR to save time & money. Same for termination clauses mandating cost accounting principles for non-commercial buys.


A&L WEEK

All Acquisition Approaches Should ...

- Lead to a fair and reasonable price
- All approaches have the same “bottom line” in mind - fair and reasonable price
- How we get there is different. PBA - more direct, efficient, appealing, sensible. CBA - sometimes circuitous, inefficient, limiting, exclusionary



Acquisition
&
Logistics
Excellence



08/09/01
Implementing Price-Based Acquisition
22

A central concept to always keep in mind: When we compare a Cost-Based Acquisition approach with a Priced-Based Acquisition approach, we should find the goal is still the same...a fair and reasonable price.

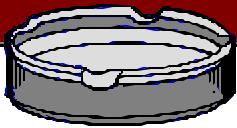
As we should now be able to surmise, a key difference in these approaches is centered on how that fair and reasonable price is determined, along with the effect a given approach has on being able to attract good firms, acquire superb products and services, etc. Under the cost-based approach, prices were determined to be fair and reasonable by evaluating estimated or actual cost data. Profit was calculated based on a number of risk factors borne by the contractor or the Government in a very formulaic fashion.

Under the price-based system, individual cost elements are subordinated to overall value analysis based on market research and other techniques that we've mentioned, as well as those waiting to be developed and used.


A&L WEEK

Another Reason Why PBA

- Cost Based Contracting - The story of the ashtray.**
- Cost based approach: reasonable, allowable and allocable may have said "ok".**
- Common sense (i.e., value and worth-based Price-Based Acquisition) would have said "no"**



Acquisition
&
Logistics
Excellence



08/09/01

Implementing Price-Based Acquisition

23

As we've mentioned, there are many good reasons for the shift from Cost-Based Acquisition to Price-Based Acquisition. As a matter of fact, Price-Based Acquisition, where the price was based on value or worth to the customer, might have prevented the "Ashtray" story from occurring.

Question: How many here have heard of the "Ashtray" story? It was the case of the \$600 ashtray that the Government purchased in the early to mid-eighties. Here the Government spent \$600 plus dollars each for ashtrays to go onto some aircraft. When it was discovered that the Government spent this much money for ashtrays, several people's careers were, as you might imagine, deleteriously affected. After this occurred, apparently some people went back to the original requirement - which might have been MILSPEC'd in the first place. When someone actually costed out the true labor and materials involved to produce those exact ashtrays, the \$600 was, indeed, a fair and reasonable price. Not a smart price - but according to Government CAS, a fair and reasonable one. They were able to establish X number of labor hours, Y amount of overhead, etc. So, when you added up all the reasonable, allowable and allocable costs, plus a reasonable fee - that's what they totaled.


A Price-Based approach would probably have resulted in a different decision. If the Government had focused on the value, or worth, of the ashtrays to the customer, the value probably would not have been \$600. In addition, a commercial item acquisition, rather than a MILSPEC, would have enabled the Contracting Officer to procure a commercial ashtray for a fraction of the amount actually paid. At the very least, with a PBA approach, the value or worth could have been compared to the cost and a better contracting/ business decision could have been rendered.


While you don't want to establish broad acquisition policies based upon isolated examples, such as this, it's good to remember that PBA can not only make great, positive strides in promoting smart acquisition techniques, but it can also help to prevent those occasional bad news stories.

A&L WEEK

What PBA Can Allow Us To Do

- **What PBA can allow us to do:**
 - Access commercial technology - products and services**
 - Expand industrial base supporting DoD - make it equal to entire output of top-notch firms**
 - Reduce Government infrastructure
 - Reduce cost of ownership - up front and on-going [better prices]
 - Increase acquisition efficiency- while maintaining public trust
- **Objectives support one another**



Acquisition & Logistics Excellence

 08/09/01

Implementing Price-Based Acquisition

24

This slide details the major objectives to Price-Based Acquisition.

First, PBA should provide much greater, access to the wide array of commercial products and services available in the marketplace. Why? Because the Government will buy a product or service without imposing burdensome requirements: such as unique accounting systems, a specific methodology of accumulating and reporting of costs, etc.

The second objective, expanding the industrial base supporting DoD, is a natural result of increasing access to the commercial marketplace. The greater the access or reach into the commercial marketplace, the greater the expansion of the industrial base supporting DoD. If the Government's needs suddenly increase, those needs can be more quickly satisfied in the existing commercial marketplace.

Here are some more objectives to be accomplished by Price-Based Acquisition.

Reduce the Government infrastructure. This infrastructure is both the resources to evaluate and award contracts, and to manage those relationships after award. If the buyer has many unique requirements it must hire, train and retain personnel to evaluate, audit and manage those unique requirements. If the unique requirements are toned down or, eliminated, the infrastructure may also be eliminated. QUESTION: If you had the power to make this decision, would you rather have 10,000 finance people, auditors and accountants, or would you rather have 9,000 scientists, engineers and production personnel, and 1,000 finance people? Ask yourself how many pens, computers, cars, satellites, etc., that those 10,000 finance people have created or

produced? The infrastructure on both side of the business transaction: buyer and seller can be reduced.

Naturally, if you can reduce infrastructures, you can reduce the costs it takes to maintain the infrastructures.

Finally, if you can reduce unique requirements, the efficiency of the acquisition process will be improved. It will be streamlined. Fewer steps need be taken to deal with non-value added unique requirements will mean increasing speed of delivery of the product to the Government customer.

A&L WEEK

Acquisition
&
Logistics
Excellence



PBA: Reaching the Marketplace

- Access technology by expanding marketplace from which products/services acquired. The “good news” & “bad news”**
- Most companies do not have Government “compliant” accounting systems**
- “When in Rome” (We’re in Rome now)**



08/09/01
Implementing Price-Based Acquisition
25

A little more information on reaching into the commercial marketplace. There is some good news to this thrust and some bad news as well.

The Government is turning to the true commercial industry from which to fulfill its needs. It is buying from the largest marketplace in the world. In this enormous marketplace - the commercial bazaar if you will - you can buy the very best products and services from the very best firms in the history of commercial enterprise. Think about it: the finest businesses in history are those that live and thrive today. If you can't find what you need here, you're certainly talking about a very special item, indeed. Why today, you can share the R&D costs with millions of other customers. For example, say you needed a piece of electronic gear and it costs one million dollars to develop it and place it in commerce. If there's a potential market for that company of one hundred thousand sales worldwide with a sales price of five hundred dollars each, wouldn't you rather pay one/one hundred thousandth of the total development cost, which would be only ten dollars per unit? Or, would you rather pay it all yourself, and pay one million dollars for an item that should cost five hundred. The answer is easy.

Here's the bad news. Unless the Government procurement community prints up special one dollar bills worth a lot more than everybody else's, you can only expect to get about one hundred cents of product or service for every dollar you spend. If you have a lot of special requirements, your dollar will not attract a seller. Buyers may not realize it, but they actually compete with other buyers in the marketplace. You know what they compete for? The products and services of the world's best businesses. Unique requirements - and Cost-Based Acquisition certainly carries a host of unique


requirements - make the Government a very unattractive buyer in the view of many world-class firms.


If you want to truly access commercial products, you need to adopt business practices and customs that are used by millions of other buyers and sellers. In other words, when you're in Rome, do as the Romans do.

A&L WEEK

Performance-based Payments

- **The preferred Government financing method- FAR 32.1001**
- **Link contractor payments to**
 - **performance**
 - **reaching a milestone**
 - **other quantifiable measure of results**



Acquisition & Logistics Excellence


08/09/01 Implementing Price-Based Acquisition 26

QUESTION: Ask class, “Has anyone here ever used PBP, or have an idea of what it is?”

Performance-base payments (PBP) are the preferred method of payment to contractor. PBP may only be used in fixed-price contracts with the agreement of the contractor. In Nov. 2000, Dr. Ganzler, former USD (AT&L) set a DoD-wide goal of 25% of all contracts over \$2 million during FY 2002 should have PBP. As of FY 1998, about 10 percent of all dollars obligated were on contracts using performance-based payments (PBA Study Report, Table 4).


What are PBP’s? They are a financing option that allows the contracting officer to make payments on a contract when a specified, quantifiable/measurable event or action takes place. The advantage is that the contractor can be paid at pre-determined points within the performance period of the contract without a submission of cost and pricing data or other onerous reporting documentation. The contractor and contracting officer simply agree that the designated event has occurred and the contractor can then be paid.

Using program milestones is a typical way to accomplish this. However, there are many others.


A&L WEEK

Major Elements of PBA

- Use commercial practices
- Maintain competitive environment -
 - multi-level competition
 - readily available alternatives
- Focus on OUTCOME value
 - tradeoff performance, cost, schedule, etc.
 - what does customer “really” want?
- Performance based (i.e. Milestone) payments
- Pay for the Value (the Worth) instead of the Cost of fulfilling the requirement



Acquisition & Logistics Excellence



08/09/01

Implementing Price-Based Acquisition

27

Notice that these elements are not especially revolutionary; but they are important, highly practical and usable. All these elements should be given consideration in every acquisition with which you are associated. If they are considered and used, you have the heart and soul of the benefits that Price-Based Acquisition can afford.

What do these elements tell us? First, focus on using commercial practices. Part 12 tells us to use commercial practices where they make sense and are not specifically precluded by law. That is a very wide berth we're given.

Another element is to maintain a competitive environment, to use competition at many levels and to have viable alternatives. By using commercial practices and tapping into the commercial marketplace, you should encourage competition.

Focus on outcome value, that is, what you want to receive as a result of the services you buy, or the supplies you acquire. We'll talk more about this element later.

Consider performance-based payments (PBP). PBP are a way of tying performance achievement, i.e., accomplishment of stages, phases or milestones to payment. This helps shift performance risk to the contractor and emphasize the necessity of successful performance.

Pay for Value at the heart of Value-Based or Worth-Based Acquisition, which is, itself, a core value underlying Price-Based Acquisition. The smartest buyers ascertain the value or worth of the products or services they are about to procure and use that as a bedrock for the price negotiations and ultimate price to be paid.

If we concentrate on cost elements, we will find ourselves paying based upon the cost for a company to fulfill our requirements instead of the value of what that fulfillment actually means to us and to our customers. This also means that we will focus on the wrong areas and often pay too much.


By using Value and Worth-Based Approaches within the ambit of Price-Based Acquisition, we are, indeed, embracing and adopting the business practices utilized by the brightest acquisition professionals in industry.

A&L WEEK

Acquisition
&
Logistics
Excellence

Performance-based Payments

- **Focus on performance of meaningful and measurable technical or schedule objectives**
- **Broaden contractor base**
- **Reduce costs of administration and oversight**
- **Program office can link financing to performance**



08/09/01
Implementing Price-Based Acquisition
28

PBP is very much in line with the tenets of performance based contracting. It relies on the accomplishment of meaningful and measurable technical and schedule objectives. By linking a contractor's payment to critical aspects of technical and schedule performance prior to contract award, PBP ensures important technical and schedule goals are met for successful performance.

Traditional cost-based progress payments can only be used with those contractors who have approved accounting systems. Since many of today's leading technology firms do not regularly perform under Government contracts they have no need for government compliant accounting systems. Use of PBP allows the DoD to eliminate one potential barrier to wider supplier participation in Defense procurements.


Reductions in the oversight and compliance costs of both the Government and contractors are practical because the accounting system is not an integral part of the contract financing process. The Government does not need auditors to review payment requests. Similarly, contractors' financing requests are event or accomplishment driven and contain no financial information that must be prepared according to federal financial regulations. Both parties should be able to reduce non-value added cost-based oversight.

PBP allows the program manager to link financing to performance in fixed price contracts because the contractor is entitled to agreed-upon payments only when specific measurable events have been accomplished. The program manager, supported by IPT members, gives the "thumbs up or down" regarding the assessment of the contractor's technical and schedule results. PBP is in effect, "self policing" because

the contractor is entitled to the agreed-upon payments ***only when*** he accomplishes the paying event and the program manager confirms it before the disbursement is made.

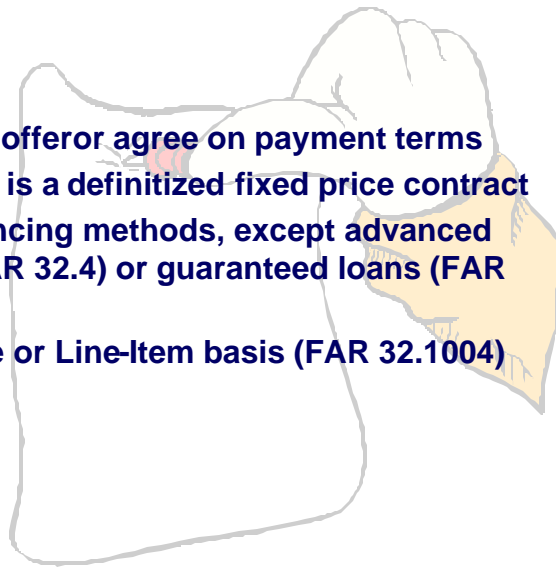
A&L WEEK

Acquisition
&
Logistics
Excellence



Performance-based Payment criteria

- The PCO and offeror agree on payment terms
- Contract type is a definitized fixed price contract
- No other financing methods, except advanced payments (FAR 32.4) or guaranteed loans (FAR 32.3)
- Contract-wide or Line-Item basis (FAR 32.1004)



08/09/01Implementing Price-Based Acquisition29

The PCO and contractor must agree on the performance bases and the amount of each payment.

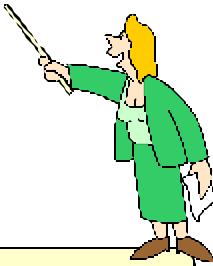
Performance-based payments may be made either on a whole contract or on a deliverable item basis, unless otherwise prescribed by agency regulations. A deliverable item for these purposes is a separate item with a distinct unit price. Thus, a contract line item for 10 airplanes, with a unit price of \$1,000,000 each, has 10 deliverable items -- the separate planes. A contract line item for 1 lot of 10 airplanes, with a lot price of \$10,000,000, has only one deliverable item -- the lot.

PBP can be used on either a contract-wide or line item specific basis. "Performance-Based" payments may be made either on a whole contract or on a deliverable item basis, unless otherwise prescribed by agency regulation. Within a contract line item, however, only one form of contract financing can be used.


A&L WEEK

PBP procedures

- **Establish performance bases**
 - Specifically described event
 - Measurable criterion of performance
 - Events may be severable or cumulative
- **Establish payment amounts**
 - Complete schedule of payments
 - Not to exceed 90% of contract (or delivery item) price



Contracting Officer must ensure that the total contract price is fair and reasonable

Acquisition & Logistics Excellence

 08/09/01

Implementing Price-Based Acquisition

30

Establishing performance bases.

Each event or performance criterion that will trigger a finance payment must be an integral and necessary part of contract performance and must be identified in the contract, along with a description of what constitutes successful performance of the event or attainment of the performance criterion. An event need not be a critical event in order to trigger a payment, but the Government must be able to readily verify successful performance of the event or performance criterion.

Events or criteria may be either severable or cumulative. Successfully completing a severable event or criterion is independent of the accomplishment of any other event or criterion. The successful accomplishment of a cumulative event or criterion is dependent on the previous accomplishment of another event.

Establishing finance payment amounts.

The contracting officer must establish a complete, fully defined schedule of events or performance criteria and payment amounts when negotiating contract terms. The contracting officer must ensure PBP amounts are commensurate with the value of the performance event or performance criterion. Contracting officers may establish payment amounts on any rational basis, including engineering estimates of stages of completion; engineering estimates of hours or other measures of effort to be expended in performance of an event or achievement of a performance criterion; or the estimated projected cost of performance of particular events.

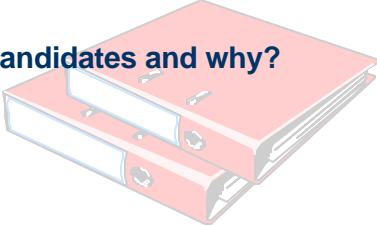
FAR 32.1004

A&L WEEK


In-Class Exercise: Which Settings May Favor Use of PBA?

- Commercial items - supplies or services
- Repeat buys - history available
- Complex, high dollar value acquisitions
- Competitive procurements
- Procurements with or where performance outcomes can be ascertained
- Sole source - with commercial items, history, benchmarks, etc
- R&D, concepts

Which ones are good PBA candidates and why?



Acquisition & Logistics Excellence



08/09/01

Implementing Price-Based Acquisition

31

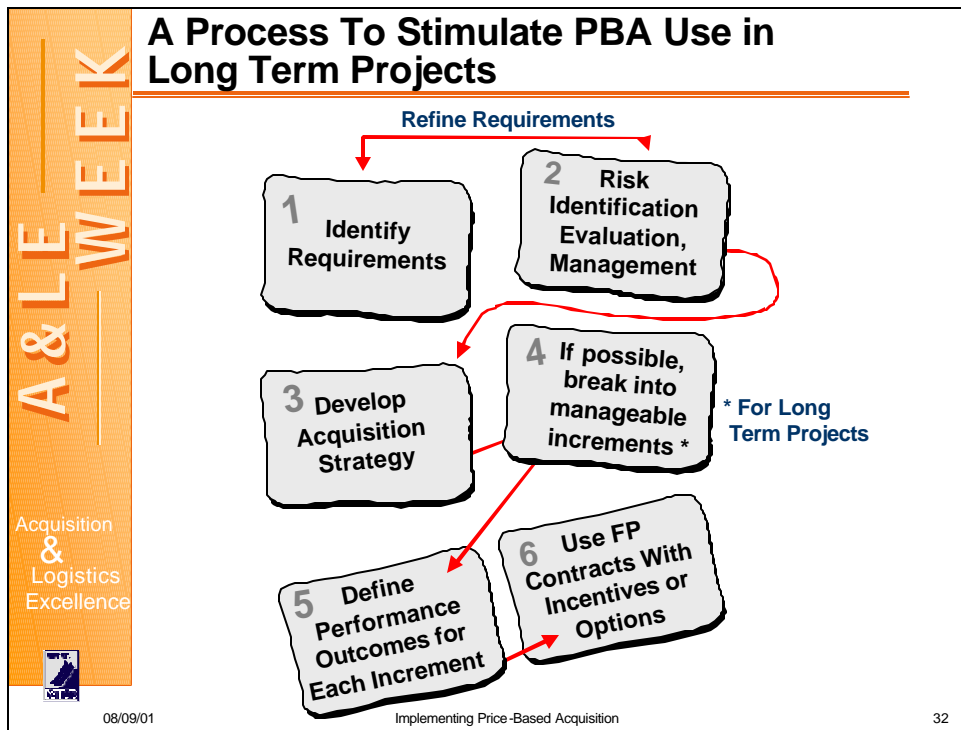
Here is an In-Class Exercise for us to begin the process of thinking about which procurements might be good candidates for applying and using Price-Based Acquisition.

Which ones do you think would favor PBA and why? [If class hesitates to answer, say something along the lines of: Remember the core areas of difference between PBA and Cost-Based Acquisition. CBA demands detailed cost data that is certified. Sometimes, it is the availability of other information, in lieu of certified cost or pricing, that supports a decision to use Price-Based Acquisition. Other times, it may be the environment in which the acquisition is conducted that promotes PBA, or even the items we are buying. Which of the settings listed provide some of the information we can use to establish a fair and reasonable price? And why?

“Answer”: based on available information to help support fair and reasonable prices, or based on what is being purchased, good candidates are: (1) Commercial items - supplies or services; (2) Repeat buys - history available; (3) Sole source - with commercial items, history, benchmarks, etc.

“Answer”: based on environment/setting good candidates are: (1) Competitive procurements; (2) Procurements with performance outcomes or where performance outcomes can be ascertained.

How about: Complex, high dollar value acquisitions, and R&D, concepts? Depends on the situation and what is being procured. Depends on information available in marketplace, etc.



Here is a process that should be considered very early in the life of any acquisition. This process is not the purview of only the contracts person, but rather of the entire acquisition team - no matter how large or small. This process, if followed may stimulate the prudent utilization of Price-Based Acquisition.

Benefit of invoking this process is that it may help convert procurements that would otherwise be Cost-Based Acquisition candidates by default, into serious PBA candidates.

Naturally, not all of the individual steps portrayed will be applicable to all acquisitions. Let's briefly go through these stages:

First, identify all the requirements, preferably in performance terms

Secondly, subject those requirements to a rigorous process of identifying, evaluating and seeking ways to manage potential risk connected with the requirements. If a PBA is likely, this is the time to apply for a waiver, if necessary, from cost or pricing data (depending on dollar threshold). The sooner this is done, the greater the benefits to both the government and industry (as they prepare proposal documents and request information from their suppliers/subcontractors).

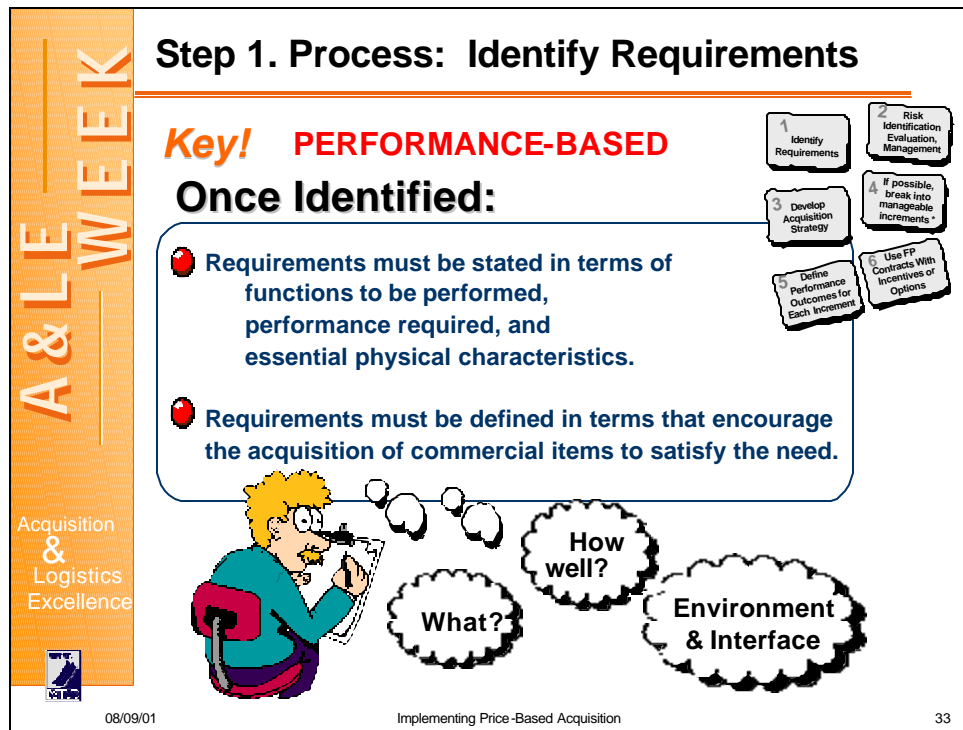
Thirdly, develop the acquisition strategy

Fourthly, if possible, seek to break down the requirements into manageable increments, or bite-sized pieces. This step is especially advantageous for longer-term projects

Fifthly, define the performance outcomes desired for each increment - if they are broken down per the last stage; or for the whole set of requirements if they are not broken down.

Finally, use fixed price types of contracts where possible, which should be particularly sensible where the requirements can, in fact, be broken down into bite-sized pieces.

In all of these steps or stages, market research is important.



The mandate of how the Government's needs are to be described is stipulated in the FAR.

This first step in this PBA process is to clearly define your need. A basic underpinning of PBA is the necessity to define, in performance terms and physical characteristics, your requirements so they may be communicated to the potential contractors. Part of this effort requires a knowledge of the market place, so early industry involvement is essential to develop and communicate requirements in a manner that the market can satisfy and in a way that encourages broad participation by contractors using the maximum amount of commercially available supplies and services. As you can see by the PBA process diagram, it is an iterative process coupled with the market research, risk identification, evaluation and management pieces.


It is important to define what you want as opposed to how it is to be accomplished. We'll see more of this topic on the next slide. This facilitates a performance based approach that allows a selection process to determine best value. In addition to determining the performance requirements, you must determine the standard of the performance you desire and analyze the value and impact of meeting, missing or exceeding the standard with regard to the customer's mission accomplishment.

A&L WEEK

 Acquisition
&
Logistics
Excellence

Performance Based & Price Based, A Difference?

- Performance-Based Acquisition & Price-Based Acquisition; certainly sound alike**
- Where does Performance-Based fit with Price-Based? Is there a link?**



08/09/01
Implementing Price-Based Acquisition
34

The more you can identify your desired performance outcomes, the more you can and should use PBA approaches. What is meant by desired outcomes? Picture the items or services the Government wants to acquire. Now, look at the functions the items are intended to perform. Throughout that performance, what does the Government want to have or achieve, that is, what is the purpose of the items? If you buy, or lease, a copy machine, the desired outcome is, frankly, not to have a large piece of equipment stuck in a small room somewhere. No, the outcome desired is the function to be performed by the machine, that is, readily available, high quality copies of data and documents. Take the same approach with services. Picture excellent performance and what do you see? You see equipment being maintained so that its availability is high; you see food being prepared and served that is attractive and nutritious; you see office buildings that are clean, dirt and dust free. Now, what is it that you are buying? Not the services because that is the wrong focus. You are buying the results of the services, that is, the desired outcomes. The more that you can focus on the outcomes, the more you can focus payment for those desired outcomes and the less you have to be concerned with estimated or incurred costs. In other words, you'll pay for the desired outcomes being completed, not simply for the "costs of doing business." If you pay based on costs: estimated or incurred, you won't be sure of receiving what you really needed. If, instead, you pay for the desired outcomes being achieved, you don't have to worry as much about the costs incurred in achieving those outcomes.

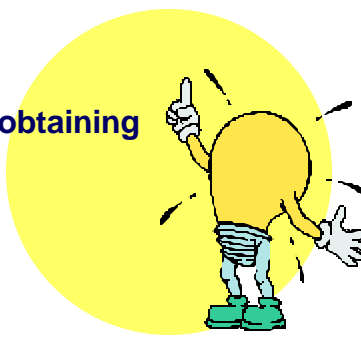
Now, the most prudent course is to combine Performance-Based Acquisition with PBA and that means to use PBA techniques such as Value or Worth-Based approaches, market research, etc. Use these on the front end of the acquisition to both describe the

desired performance outcomes and to decide the price that you should pay for the results that you want.

A&L WEEK


Value Drivers

- What does this product or service do?
- How much have we paid in the past?
- What alternatives to accomplishing this exist?
- What else about this is important to our mission?
 - Time criticality
 - Mission need
- What is the cost of not obtaining this product/service?



A&L WEEK

Acquisition
&
Logistics
Excellence



08/09/01

Implementing Price-Based Acquisition

35

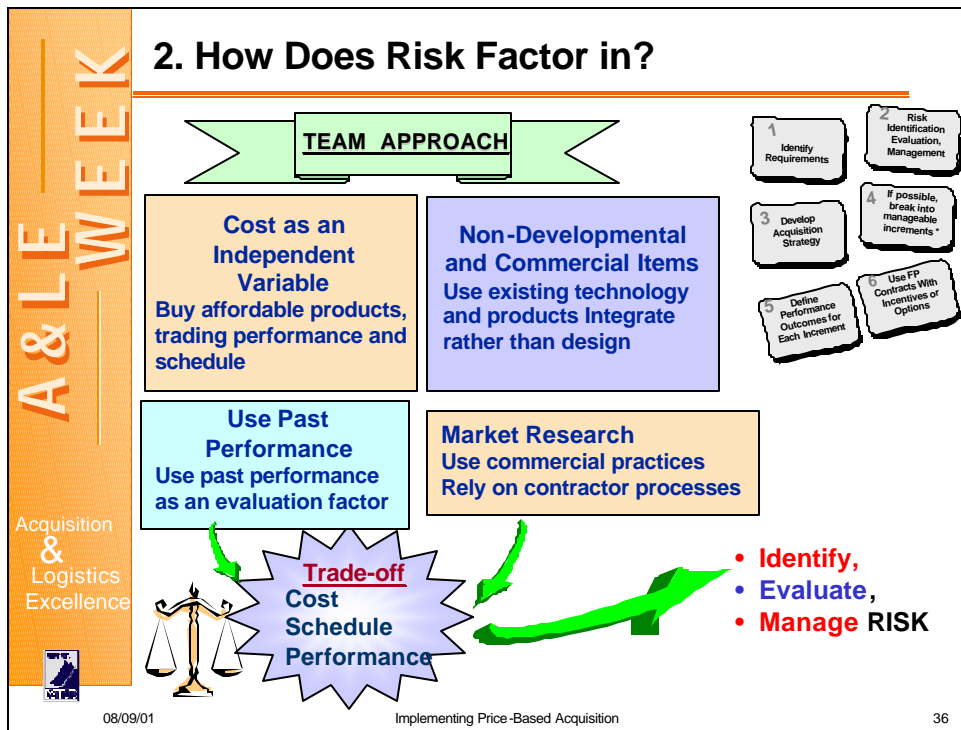
Now is the time for the Program Manager (and the IPT or Acquisition Team) to determine the value of the proposed procurement to the Government.

How to determine the value? Just as in a Cost-Based Acquisition, there are cost drivers, there are drivers to the value of the products or services being acquired.

The members of the acquisition team must take some time to sort out what is important about the product service being acquired. What functions are critical? What functions are “nice to have”?

Each of these listed “drivers” of value- those functions that are important to the program office- must have a dollar figure assigned to them. The value of an item and the dollar amount paid for an item are linked. The total “value” represents what this procurement is “worth” to the government. An amount paid in excess of that amount, then, would exceed the “value.”

Documenting those drivers ensures the required functionality is included in the solicitation package as well as a result of all negotiations.



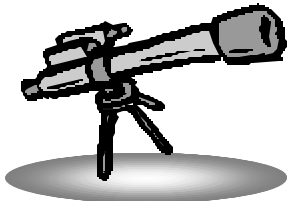
If we don't identify, evaluate and manage risk in our procurements, it can manage us. Acquisition Teams should have an effective, intelligent approach to first identify risk; second to evaluate the degree of risk in being able to satisfy the customer's needs; and third, to successfully manage risk throughout both the evaluation/award process as well as the post award phase.

The ideas and techniques displayed on this slide can be effective at all three phases of determining risk, i.e., identifying, evaluating and managing risk. For example, the more we use commercial items, generally, the lower the risk. The more market research we perform, the more we can identify and lower the risk. The more we use commercial practices, the more we can manage and lower the risk. The more we use past performance as an evaluation factor, the more we can identify and lower the risk. Often, the price we can afford to pay drives the amount of risk we must accept. This means that sometimes we must balance price, schedule and performance. Risk is an important aspect of all three of these ingredients.

A&L WEEK

3. Developing the Acquisition Strategy

Look Long Term



1 Identify Requirements

2 Risk Identification Evaluation, Management

3 Develop Acquisition Strategy

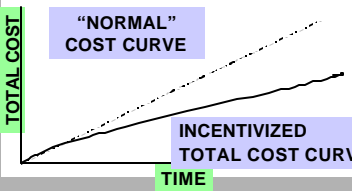
4 If possible, break into manageable increments *

5 Define Performance Outcomes for Each Increment

6 Use FP Contracts With Incentives or Options

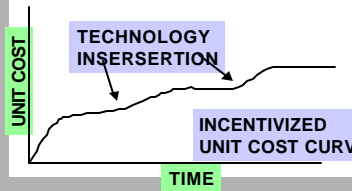
Consider Total Ownership Cost and creative ways to reduce it using PBA

"NORMAL" COST CURVE



INCENTIVIZED TOTAL COST CURVE

TECHNOLOGY INSERTION



INCENTIVIZED UNIT COST CURVE

08/09/01
Implementing Price-Based Acquisition
37

After you've identified the requirements and identified, evaluated and attempted to manage attendant risk, it's time to turn attention to generating a LONG TERM perspective with respect to the Government's needs.

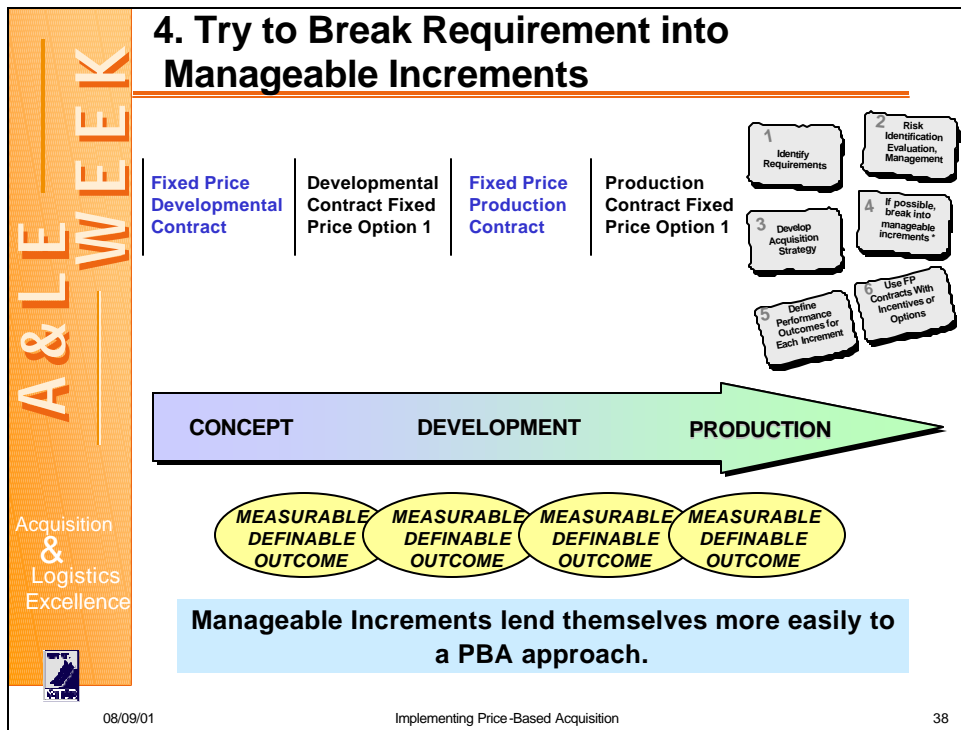
Why take a long-term perspective? Looking long term when the requirements have the potential for a long-term duration makes good, solid, business sense. Major weapon system design, development and fielding is a long-term proposition. If we're buying services - many times the requirement will be with us for much more than one year. Think about examples such as grounds maintenance or equipment maintenance. If we're buying supply items, the useful life is, often, calculated in terms of years, not months - unless, of course, we're buying consumables.

Other reasons to take a long-term perspective? To improve performance over time or reduce price over time. Sometimes performance improvements can also reduce price outlays as well.

Most everything we buy has a cost or price curve or trend. Mostly the trend is upward. What can we do to blunt the steepness of the curve? One thing is to think long term. Real costs may decline over time. Example: A business goes after a \$1,000,000 twelve month contract; no options. It spends \$50K winning it and spends another \$50K in "startup costs. It must recover these costs, i.e., amortize them over the contract period. So, in addition to receiving \$1,000,000, it must receive another \$100K. Think about the price curve. Now think what it would be like if the company can amortize, i.e., recover that \$100K over a two, three, four or five year contract period. See how the cost curve would not be as steep? Businesses absolutely must consider these issues;

so should the Government when it acquires goods and services. This approach can separate the winners from the losers.

Also, sometimes, we can infuse or insert newer technology into what we buy to increase performance or maybe reduce operational costs. The longer-term perspective we take, the greater opportunity we'll have to do that.



Do we ever have long term requirements, such as a weapon systems or long term service needs? If so, it may make sense to strongly consider breaking them down into discrete pieces whenever specific performance outcomes can be articulated for each increment. Then the increments of contract time, phase or length can be tied to or based on performance increments. In attempting this approach, be sure that market research is done. Look at and contact industry acquisition teams. Ask them if they use this approach on similar, long term requirements. Find out the details and how well it worked or didn't work. Copy the good ideas and learn from their mistakes.

Another, similar approach is called an evolutionary acquisition. The evolutionary approach is characterized by the design, development, and deployment of a preliminary capability using current technology that includes provisions for the evolutionary addition of future capabilities as requirements are further defined and technologies mature. Such a system may start as an update of a current system, that over time becomes a radical new way of accomplishing the mission. Until the technology is developed and incorporated, then the interim "versions" are able to function as a planned, "evolving" system.

Remember, we're still taking a long term view. Now, what we're doing is dividing up the long journey into a series of smaller steps. We are combining the long term focus with the benefit of looking at a series of performance stages, where we can more clearly see the performance outcomes at the ends of the various stages. We can do this whenever it becomes very difficult to see exactly what we want at the end of a very long requirement.

A&L WEEK

5. Define Performance Outcomes & Standards

What are desired Performance Outcomes for:

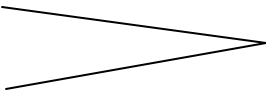
- Each increment, when broken down, or
- Total contract

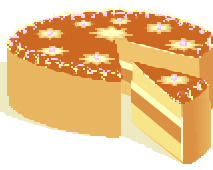
Outcomes must be measurable - so success is discernable

“The item should do the following: _____”

“The service should result to the following: _____”

| |
|-------|
| Ready |
| |
| |
| |
| |





08/09/01

Implementing Price-Based Acquisition

39

We have stressed knowing the performance outcomes we desire as a result of performance. This is intimately linked with Price-Based Acquisition - since it allows us to focus on paying for performance, i.e., pay for successful results and not just pay for effort expended (and dollars expended). When we pay for performance we are on the road to fixed price, non-Cost or Pricing Data requirements procurements. When we're just paying for efforts or dollars expended, we tend to be Cost-Based and Cost or Pricing Data oriented.


There is more to it than just determining performance outcomes, however. We need to have performance standards - so that we can fairly ascertain whether or not the outcome has truly been achieved and that the outcome warrants payment. This may be easier said than done. This warrants serious attention and is another excellent area for market research. Again, contact industry acquisition teams and professionals. Ask them how they measure performance and how they pay for it. Use the good ideas, discard the rest. Performance Outcomes and Standards promote effective PBA.

A&L WEEK

6. Use Fixed-Price Contracts

Contract Type Affects:

- Contract Performance
- Contract Price
- Competition



1 Identify Requirements

2 Risk Identification Evaluation, Management

3 Develop Acquisition Strategy

4 If possible, break into manageable increments *

5 Define Performance Outcomes for Each Increment

6 Use FP Contracts With Incentives or Options

Fixed Price, if contractor knows:

What it's getting into (size, complexity of effort)

What is criteria for judging success of effort

Cost
➔
Fixed Price

08/09/01

Implementing Price-Based Acquisition

40

Clearly, the ideal under a PBA approach, is a firm, fixed price contract with a great deal of market competition. In the real world, the market place will largely dictate what will be acceptable as a contract type.

We would normally prefer a fixed price contract because it shifts much of the performance risk to the contractor, while at the same time allowing it to maximize profit through excellent performance, cost control or both.


To the prudent contractor, a fixed price contract is often a function of the answers to two questions that it asks, either formally, or through an unstated decisional process. The questions, and their variations, are (1) what are we getting into, i.e., what will it take to do the work; how big is the effort, how complex, etc.? In other words, can we do it? (2) What will be the criteria for judging success (or failure)? In other words, how well are the outcomes and standards defined? What is the risk of failure, etc.? The answers to these questions - when favorable, move in the direction of a fixed priced contract; when negative, move in the direction of a cost type contract.


The incremental or evolutionary approach from Step 4 helps shorten the contractor's risk horizon and may make a fixed price contract more acceptable.

A&L WEEK

Final Thought

- PBA is more than just “Buy Commercial”**
- DoD wants to deal with “Dual-Use” capable commercial firms - to produce **MILITARY UNIQUE** items alongside commercial items**
- Flexible manufacturing techniques**
- BUT firms won’t go for it unless we use PBA not CBA and require information other than C/P Data**



Acquisition & Logistics Excellence

 08/09/01

Implementing Price-Based Acquisition

41

Lest anyone think that PBA is just another way of saying “buy commercial items”, let’s think about this slide for a moment. There are good businesses, who through a capability called “flexible manufacturing”, are dual use capable. This means that they could, if they wanted to, produce military unique products at the same time they are producing commercial items.


This could provide a greater expansion of DoD’s industrial base, greater competition, lower prices, better technology and reduced cycle times.

The problem with tapping into these firms is that if we say to them: since we are not buying commercial items - as defined under Part 2 of the FAR and exempt from Cost or Pricing Data - we need to have a Cost-Base Acquisition and Cost or Pricing data; they will not want to do business with us.

This means that the concepts and principles behind Price-Based Acquisition that we covered today should also be extended into even the non-commercial products and services we procure if we want to have a chance to succeed in our Revolutions in both Business and Military Affairs.

A&LE
WEEK


Acquisition
&
Logistics
Excellence



Overview - Summary

Price-Based Acquisition -

- Common sense approach often found in commercial marketplace
- Can attract more industry players
- Can streamline acquisition process
- Can reduce costs and obstacles



08/09/01

Implementing Price-Based Acquisition

42

This brings us to a conclusion of Price-Based Acquisition. To summarize: it is a logical, common sense approach to acquisition. PBA is and has been heavily used in industry.

PBA is not a silver bullet. But it has, when implemented correctly, serious and dramatic benefits such as the ones on this slide and the ones we've covered in the lecture.

As a suggestion, you might want to take the lecture slides and provide copies to all the members of your future acquisition teams. But, provide them early. Have a pre-kickoff meeting and discuss the feasibility of making conscious efforts to implement Price-Based Acquisition into your procurement from the earliest stages. More often than not, at the conclusion of the contract award and performance under the contract, you'll be very happy that you decided to use PBA.

Recommended Reading and Resources

Price-based Acquisitions:

- "Price-Based Acquisitions," Dr. J.S. Gansler, Under Secretary of Defense for Acquisition, Technology, and Logistics, Nov 29, 2000.
- "Paving the Way for Price-Based Acquisitions," Edward L. Will, Acquisition Review, Fall 1999, Vol. 6, No. 4. Pages 369-381.
- "Office of the Secretary of Defense / Industry Price-Based Acquisition Roundtable, Executive Report," Office of Secretary of Defense, December 1998.
- "Report of the Price-Based Acquisition Study Group," Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics, November 15, 1999.
- "Price Based Acquisitions," Vernon J. Edwards, Where in Federal Contracting, <http://www.wifcon.com/analpricebased.htm>, 1999.
- "DCMA- Price-based acquisitions," <http://www.dcma.mil/reference/pba.htm>

Performance-based payments:

- "Performance Based Payments," Director, Defense Procurement, Eleanor R. Spector, 9 November 1998.
- "Use of Performance-based Payments," Dr. J.S. Gansler, Under Secretary of Defense for Acquisition, Technology, and Logistics, Nov 13, 2000.
- "Performance Based Payments," <http://www.dcma.mil/onebook/9.0/9.3/PerfBasedPay.htm>, revised May 2001.